**Calendar No. 301**

| 101ST CONGRESS *1st Session* | SENATE | REPORT 101-169 |
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# ACQUISITION OF CONTROLLING INTEREST IN AIR CARRIER

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Mr. HOLLINGS, from the Committee on Commerce, Science, and Transportation, submitted the following

## REPORT

together with

ADDITIONAL VIEWS

OF THE

## SENATE COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

ON

S. 1277

OCTOBER 18 (legislative day, SEPTEMBER 18), 1989.—Ordered to be printed

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# ACQUISITION OF CONTROLLING INTEREST IN AIR CARRIER

OCTOBER 18 (legislative day, SEPTEMBER 18), 1989.—Ordered to be printed

Mr. HOLLINGS, from the Committee on Commerce, Science, and Transportation, submitted the following

## REPORT

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## ADDITIONAL VIEWS

[To accompany S. 1277]

The Committee on Commerce, Science, and Transportation, to which was referred the bill (S. 1277) to amend the Federal Aviation Act of 1958 to prohibit the acquisition of a controlling interest in an air carrier unless the Secretary of Transportation has made certain determinations concerning the effect of such acquisition on aviation safety, having considered the same, reports favorably thereon with an amendment and recommends that the bill do pass.

### PURPOSE OF THE BILL

The bill requires the Secretary of Transportation to give prior review and approval to any acquisition of the controlling interest in an airline to ensure that such an acquisition would not materially and adversely affect the carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety.

### BACKGROUND AND NEEDS

In June, after a number of offers from various parties, Northwest Airlines announced the acceptance of a $3.8 billion tender offer from Wings Holdings, Inc. for all of its outstanding stock. Of that amount, $3.1 billion will be new debt. Recently United Air Lines

39-010

accepted a takeover offer of $6.78 billion from Airline Acquisition Corp. Including funds needed to finance the tender offer, pay related fees, refinance existing debt, and provide working capital for the new carrier, the transaction reportedly would have left United with $7.2 billion in new debt. In early October, Donald Trump proposed the acquisition of American Airlines for $7.5 billion, which would have imposed at least $6 billion in new debt on the carrier.

The goal of the investors in a typical leveraged buyout is to maintain private ownership for up to seven years, during which time the substantial debt incurred to finance the acquisition can be reduced through increased operating cash flows or selected asset sales. The Committee is concerned that with a highly leveraged airline industry, passenger safety and service may be severely compromised. In order to service increased levels of debt, a highly leveraged carrier could be forced to sell existing aircraft or cancel new aircraft orders, or sell established international routes. A highly leveraged airline industry could be expected to reduce resources devoted to maintaining its aging aircraft fleet.

If a recession were to occur, both business and discretionary travel would decline. This would substantially reduce the revenue available to any air carrier. This will only exacerbate the desperate situation faced by highly leveraged airlines carrying substantial debt service loads. With a serious recession, fuel costs may rise, thus reducing airline revenues and further threatening a highly leveraged carrier with the possibility of bankruptcy. Regardless of the overall economic situation, a highly leveraged airline will become much more conservative, focusing greater attention to its financial condition rather than undertaking aggressive, possibly risky, expansion plans. Highly leveraged airlines will probably not have the resources to develop new business in growing international markets such as East Asia. In the extreme, the Committee is concerned that the U.S. airline industry could become so loaded with debt from the current wave of leveraged buyouts that foreign airlines, with their large reservoirs of cash, would be better situated to expand into fast-growing international markets.

In addition to increased debt, continued control of U.S. airlines by American citizens has been an issue in these transactions. Under the Federal Aviation Act of 1958, the President and two-thirds of a carrier's board of directors and other managing officers must be U.S. citizens, with 75-percent of the voting stock in the company owned or controlled by U.S. citizens. In the original proposal to acquire Northwest Airlines by Wings Holdings, Inc., the Secretary of Transportation correctly looked beyond these statutory requirements to the issue of actual control of the carrier by U.S. citizens. By contributing $400 million in equity, or nearly 57-percent of the total equity investment, KLM Royal Dutch Airlines was therefore in a position to exercise control over the future activities of Wings and Northwest. In its proposal to acquire United Air Lines, the Airline Acquisition Corp. included an equity contribution by British Airways that equalled 78 percent of the total equity investment. While this was proposed to be in exchange for a 15-percent ownership interest of United, the Committee is concerned that such up-front investment will give foreign carriers the ability to establish significant control over U.S. airlines.

There is no current Federal authority to approve or disapprove the takeover of a U.S. air carrier. However, under section 401(r) of the Federal Aviation Act, the Secretary has an on-going responsibility to ensure that an airline remains fit to operate. The Secretary of Transportation's statutory authority for enforcing this fitness standard is withdrawal of the carrier's operating certificate, thereby forcing it to cease operations, stranding hundreds of thousands of passengers every day.

The Secretary of Transportation has succeeded in working with the parties of these early airline acquisitions to ensure that the public interest is given full consideration. The Secretary went to great lengths in the Wings Holdings acquisition of Northwest Airlines to achieve a consent order agreed to by Wings Holding and DOT. However, this order did not include KLM. Therefore, the Secretary's ability to "jawbone" each participant into accepting his terms in future transactions without challenge may diminish. Future Administrations may be less likely to willingly undertake such a thorough review of airline acquisitions, thus leaving financial markets and dealmakers to effectively dictate the future of the airline industry.

Legislation is needed to ensure that the public interest is considered before the consummation of future airline acquisitions. Of particular importance are the issues of excessive airline debt and the possible shift in control of U.S. carriers to foreign entities. The bill is designed to protect the travelling public by requiring prior approval by the Secretary of Transportation of any acquisition of a controlling interest in a U.S. airline to ensure that such a transaction would not materially and adversely affect the carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety. To assist the Secretary, specific criteria have been established in this bill. Finally, in order to ensure timely completion of his review, the bill requires the Secretary of Transportation to complete action on the proposal within 90 days after receiving an application for approval.

## Legislative History

S. 1277 was introduced by Senator Ford, the Chairman of the Aviation Subcommittee on June 23, 1989. It has been cosponsored by Senators McCain, Nunn, Bentsen, Kerry, Gore, Inouye, Exon, Sasser, Boren, Sanford, Bryan, Helms, Shelby, Pell, Matsunaga, Daschle, Fowler, Kassebaum, Rudman, Rockefeller, and Kennedy.

The Aviation Subcommittee held a hearing on the bill on July 14, 1989. Witnesses included representatives from the Department of Transportation, the Minnesota Attorney General, and representatives from airline labor groups and the financial investment community. A second hearing was held on October 4, 1989, to examine the issue of foreign investment in U.S. airline industry. The Secretary of Transportation testified before the Subcommittee, as did representatives from the airline industry, and a financial investment analyst.

On October 5, 1989, the Committee met in open executive session to consider S. 1277. After adopting an amendment by Senator Ford, the Committee ordered the bill favorably reported on a voice vote.

## Summary of Major Provisions

As reported, the bill:

1. Establishes Congressional findings with respect to how an airline in a seriously weakened financial condition may pose an increased risk to safety and reliability, and that the public interest requires a review of airline acquisitions in which indebtedness is significantly increased to assure that the public interest in airline safety and service is maintained.

2. Prohibits any person from acquiring a controlling interest in an air carrier, which is defined as being direct or indirect ownership of 25 percent or more of the carrier's voting stock, unless the Secretary of Transportation has determined that such a transaction will not materially and adversely affect the carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety.

3. Requires a written application for determination to be filed with the Secretary, with the final order or decision to be issued not later than 90 days after the application is submitted.

4. Requires the Secretary, prior to making a determination required under this bill, to consider the likely effects of the proposed acquisition on the ability of the airline to comply with established safety standards, to replace existing aircraft and expand its aircraft fleet, to fulfill its commitment to maintaining and improving airport facilities, and to ensure control by U.S. citizens with a proposed equity investment by foreign carriers, and on competition on international routes.

5. Imposes the burden of proving that the proposed acquisition will not adversely and materially affect the airline's fitness and ability to operate at the highest degree of safety upon the proponents of the acquisition.

## Estimated Costs

In accordance with paragraph 11(a) of rule XXVI of the Standing Rules of the Senate and section 403 of the Congressional Budget Act of 1974, the Committee provides the following cost estimate, prepared by the Congressional Budget Office:

October 12, 1989.

Hon. Ernest F. Hollings,
*Chairman, Committee on Commerce, Science, and Transportation, U.S. Senate, Washington, DC.*

Dear Mr. Chairman: The Congressional Budget Office has reviewed S. 1277, a bill to amend the Federal Aviation Act of 1958 to prohibit the acquisition of a controlling interest in an air carrier unless the Secretary of Transportation has made certain determinations concerning the effect of such acquisition on aviation safety. This bill was ordered reported by the Senate Committee on Commerce, Science, and Transportation on October 5, 1989. CBO estimates that enactment of the bill would result in costs to the federal government of $600,000 to $1.1 million annually, assuming appropriation of the necessary funds.

S. 1277 would require that the Secretary of Transportation give prior approval to all acquisition of controlling interests in air carri-

ers. The bill specifies a number of factors that must be considered in determining whether or not a particular acquisition should be approved. CBO estimates that the additional workload created by S. 1277 would typically result in costs to the federal government of $500,000 to $1 million annually. However, costs could be higher in some years if the number, size or complexity of any major acquisition is unusually great.

No costs would be incurred by state or local governments as a result of enactment of this bill.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Mitchell Rosenfeld, who can be reached at 226-2860.

Sincerely,

ROBERT D. REISCHAUER.

## REGULATORY IMPACT STATEMENT

In accordance with paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee provides the following evaluation of the regulatory impact of the legislation, as reported.

### NUMBER OF PERSONS COVERED

The legislation authorizes the Secretary of Transportation to review and make determinations on airline acquisitions of 25 percent or more of the voting stock of an air carrier. Airlines involved in an acquisition, and their employees, would be covered by the bill, as would any individual or organization working to complete such an airline takeover.

### ECONOMIC IMPACT

This legislation requires no additional appropriation or spending authority and, therefore, would have no effect on the Federal budget. The Secretary's decision regarding specific acquisitions could affect the air carrier as well as the bidder, but the economic impact would vary in degree and direction with each individual case.

### PRIVACY

None of the provisions of this legislation should affect the personal privacy of individuals involved.

### PAPERWORK

This legislation requires that the Secretary of Transportation issue a decision or order after review of an airline acquisition involving 25 percent or more ownership. The legislation will generate additional paperwork requirements for affected air carriers and the bidding parties as they comply with the information requirements set by the Secretary for his review of the proposal. This increase is expected to be slight, however, as the paperwork requirement established under this bill is not expected to be significantly greater than required by the Secretary in his review of recent acquisition cases.

## SECTION-BY-SECTION ANALYSIS

### SECTION 1

This section contains Congressional findings which state that there is a direct national public interest in airline safety and reliability; that the U.S. Government has a responsibility and an obligation to assure the traveling public of the safety and reliability of air carriers; that an airline in seriously weakened financial circumstances may take actions that result in reduced maintenance expenditures, avoid or reduce commitments to modernize its fleet, or avoid or reduce commitments to improvements at airport facilities in order to meet its financial obligations; that air carriers with excessive debt burdens may pose an increased risk to air carrier safety and reliability; and that the public interest requires a review of acquisitions of control of air carriers which significantly increase indebtedness, in order to assure that the public interest in air carrier safety and service is adequately protected.

### SECTION 2

This section amends section 401 of the Federal Aviation Act of 1958 by adding a new subsection (s)(1) which prohibits any person from acquiring, either directly or indirectly, a controlling interest in an air carrier, unless the Secretary of Transportation has made a prior determination, after notice and hearing, that such an acquisition will not adversely and materially affect that carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety.

Paragraph (2) requires that an application for determination by the Secretary shall be made in writing, and shall be in such form and contain such information as the Secretary specifies by regulation. The Secretary is directed to issue a final order or decision with respect to a determination under this subsection not later than 90 days after the date of submission of such application.

Paragraph (3) requires the Secretary, prior to making a determination under this subsection, to consider the likely effects of the proposed acquisition upon (A) the ability of the carrier to avoid any deterioration in established safety procedures; (B) the existing commitments and future ability of the carrier to replace aircraft in its fleet with new aircraft; (C) the existing commitments and future ability of the carrier to expand its aircraft fleet through the purchase or lease of new aircraft; (D) the ability of the carrier to continue to meet its commitments to maintain and improve airport and related ground facilities; (E) the ability of U.S. citizens to control the carrier, in light of how aspects of the proposed acquisition may affect such control, including any equity to be contributed by a foreign air carrier; and (F) competition in foreign air transportation.

The Committee's first priority is aviation safety, and it expects that the Secretary will focus his review of any acquisition application on the carrier's safety practices and procedures to ensure their continuation. The Committee expects the Secretary to carefully examine the debt structure proposed in any takeover, and the effect of the debt on the carrier's ability to conduct air transportation

with the highest degree of safety, particularly focusing on potential performance during a sustained economic downturn. Increased debt is also the key item of consideration in reviewing a carrier's ability to fulfill commitments for modernizing and expanding its fleet and for maintaining and improving the carrier's ground facilities.

The Committee is greatly concerned about the level of equity investment by foreign air carriers included in several of the early airline takeover proposals. Most notable is an equity investment by KLM equalling 57 percent of the total equity proposed in the original takeover of Northwest Airlines by Wings Holdings, Inc., and 78 percent of the total equity investment by British Airlines proposed in the United Airlines acquisition. In spite of existing statutory limitations on foreign ownership of U.S. airlines, the contribution of significant sums of money up front, particularly in a highly leveraged buyout, presents an opportunity for those foreign carriers to exert control over the future direction taken by the U.S. airline. While realizing the benefits provided by foreign capital invested in our economy, the Committee expects that the Secretary will ensure that a shift in control of a U.S. air carrier to foreign interests does not occur.

The Committee also believes that any airline acquisition review must include an examination of its effect on international route competition. Every major U.S. carrier operates routes to foreign countries, awarded on the basis of factors designed to ensure maximum competition with foreign carriers. Foreign investment in a U.S. carrier operating or seeking routes also served by a carrier from that foreign nation could endanger the competitive structure on which those routes were awarded and, therefore, must be accounted for by the Secretary in the review mandated under this bill.

It is the Committee's expectation that in conducting his review, the Secretary will strive at all times to be fair and equitable to all parties, specifically by attempting to ensure that the same standards are applied to all airlines to the extent the facts are similar in each case. Consistency in the application of these criteria is necessary not only for fairness to the airlines involved, but also to avoid the competitive distortions which may result from regulatory treatment, to provide an equivalent level of protection to all passengers without regard to the airline involved, and to preserve the Secretary's fitness authority from challenges that it is being exercised in an arbitrary manner.

Paragraph (4) states that the proponents of the acquisition of a controlling interest shall bear the burden of proving that the proposed acquisition will not adversely and materially affect the air carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety. If the Secretary determines that the proposed acquisition would adversely and materially affect the carrier, with respect to one or more of the factors set forth in paragraph (3), the Secretary shall issue a determination disapproving the acquisition.

Paragraph (5) defines "controlling interest" with respect to an air carrier as being direct or indirect ownership of 25 percent or more of the voting stock of such air carrier.

## ADDITIONAL VIEWS OF SENATOR LLOYD BENTSEN ON S. 1277

The Committee has taken a significant step forward with this legislation, and I fully support the direction it leads us. The legislation would prohibit the acquisition of a controlling interest in an airline unless the Secretary of Transportation (the "Secretary") has made certain determinations with respect to the impact of the transaction on aviation safety. The bill sets forth six areas in which the Secretary shall make specific determinations. Although the legislation itself speaks with specificity concerning what factors should be taken into account when evaluating a proposed acquisition, they fall into three general areas:

The ability of the carrier to meet safety requirements;

The ability of the carrier to meet its own capital improvement needs and contribute its fair share to improve the aviation infrastructure; and

The impact of foreign equity ownership on domestic control of the air carrier and competition on international routes.

Leveraged buyout (LBOs) have increasingly become a darling of the merger and acquisitions trade in recent years, and neither Congress nor the Executive branch has exercised the kind of oversight of these transactions that is warranted as a matter of national policy. Government review of every business decision is to be avoided at all costs, but surely some transactions merit, even require, the government to take more than a passing interest in them. Some industries are so closely intertwined with the achievement of national goals and the security of the public that the government has a responsibility to ensure, through its regulatory powers, that the public interest is not undermined by the quest for private gain.

At the outset, I should state that I am not per se opposed to all LBOs. I recognize that management of companies can become lethargic, and companies need to be stripped of high costs and increase their productivity. Sometimes LBOs help to bring about that result. I have become concerned, however, about the amount of debt in these transactions, and the effect of that debt on the takeover target, the industry it impacts, and the economy as a whole. Judged on this basis, the mergers and acquisitions trend of the last few years has been a mixed blessing. In some instances, companies have become more efficient, streamlined, and productive. Too few, however, have been so lucky.

Many of these companies have simply ended up leveraged to the hilt, deeply in debt. After the takeover battle has been waged, the result is often a company that cannot provide the level of service or produce the quality and volume of goods it once did. In an effort to stave off creditors and avoid bankruptcy, the fire sale begins. Quality suffers. Assets are sold. Employees furloughed. Lives disrupted. What started out as a boon for short-term shareholders

turns out to be a bust for everybody else. I do not want to see this occur in the aviation industry, and S. 1277 is designed to safeguard against that eventuality.

### LEVERAGED BUYOUTS IN THE AVIATION INDUSTRY AND THE ROLE OF THE FEDERAL GOVERNMENT

The LBO has crept into the aviation industry. It is time Congress took notice. We should notice for a variety of reasons, the chief of which is safety. Although the airline industry was deregulated during the Carter Administration in 1978, Congress did not intend to deregulate safety. That is an area where the government still plays, and should continue to play, a pivotal role. The presumption of this legislation is that some economic decisions are so critical to the fitness of an air carrier to operate safely and to meet other weighty public interest requirements that the government's role should be something other than mere spectator; it must be a fair evaluator in behalf of the public interest.

During hearings on S. 1277, the Secretary and those serving under him voiced a concern about the necessity of the legislation. They did not believe the authority provided by this bill was necessary, believing that the Secretary's authority to withdraw an air carrier's operating certificate was adequate to meet the concerns indentified by this bill. While it may well be that the Secretary's authority to accomplish the goals of this legislation is implicit under the dictates of the Federal Aviation Act, the likelihood of increased LBOs in the industry persuades me that the authority should be made explicit to dispel any doubt.

Moreover, I am troubled by the suggestion that withdrawal of an air carrier's operating certificate is an appropriate remedy in an imprudent LBO transaction. To be sure, if the Secretary determines that an air carrier is unfit, he should not hesitate to resort to this extraordinary remedy. S. 1277 seeks to avoid this situation by requiring the Secretary to make certain determinations before an LBO has a chance to threaten the fitness of an air carrier. Fitness questions would be answered prior to the acquisition.

It appears that the only difference we have with the Secretary about LBOs and their potential impact on aviation safety is at what point is Federal intervention most appropriate: before the transaction is culminated or after it has gone bad. It is wholly unnecessary for the Federal Government to stand paralyzed in the face of an impending LBO which is likely to undermine a healthy airline. A "wait-and-see" attitude could needlessly sacrifice a thriving economic entity. The ultimate remedy of the withdrawal of an operating certificate, with its concomitant disruption to passengers, employees, shareholders, creditors, and the industry, could more easily be avoided if the Secretary undertakes a preliminary evaluation of the proposed transaction, which is all S. 1277 requires him to do. Probably, the worst that could happen is that the acquisition would be unfavorably reviewed by the Secretary and the air carrier would simply return to the status quo.

Furthermore, S. 1277 is not intended to restrict the Secretary's latitude or inhibit his creative approach in evaluating the merits of an airline LBO or other takeover transaction. In my view, there

would be nothing inconsistent with S. 1277 if the Secretary elected also to provide appropriate guidelines to the public to identify areas that would trigger the highest degree of Departmental scrutiny of a proposed acquisition. Not only would such guidelines lend some stability to the industry, it would give investors notice about the permissible bounds of an appropriate transaction without dictating to them how to structure it. Appropriate guidelines would serve to respond to criticisms that ad hoc evaluations of proposed transactions contribute to market uncertainty and suggest arbitrariness on the part of government.

S. 1277 IS NOT INTENDED TO PROHIBIT FOREIGN INVESTMENT IN U.S.-FLAG CARRIERS

A review of a proposed transaction by the Secretary under S. 1277 would be triggered when anyone acquired "directly or indirectly a controlling interest in an air carrier." "Controlling interest" is defined as "direct or indirect ownership of 25 percent or more of the voting stock" of an air carrier. It has been suggested by the opponents of this legislation that the provision is primarily aimed at foreign investors; that we seek to discourage and/or minimize foreign investment in domestic carriers through this legislation. This view evinces an unwarranted degree of paranoia about the congressional intent. On its face, the provision shows no citizenship bias. It applies to anyone who acquires 25% of the voting stock of a company, be they citizens or noncitizens.

Laid bare, this criticism is not aimed at S. 1277 at all, but it is directed at section 101(16) of the Federal Aviation Act which mandates that the President and two-thirds of the Board of Directors and other managing officers of an air carrier be United States citizens, and that 75 percent of the voting stock in the company be owned or controlled by citizens of the United States. One national news publication editorialized against this provision of the Federal Aviation Act, characterizing it as "a foolish law, a relic of another time," and suggested that it be abolished.

Whether or not this well-settled law should be abolished is an argument for another day. But it is not adequate reason to oppose S. 1277. S. 1277 is intended to provide the Secretary with explicit authority to scrutinize proposed acquisitions of domestic carriers regardless of citizenship status. Since so many of these acquisitions entail increasing the debt load of an air carrier by substantial proportions, the Secretary must take into account the impact of the transaction on the air carrier's ability to carry out longstanding legal requirements, most of which are Safety related. The legislation takes aim at heavily leveraged transactions, not foreign investment.

Of course, the amount of foreign investment in a domestic air carrier may well implicate national security concerns, competition on international routes, and the ability of the Secretary to negotiate bilateral aviation agreements with foreign countries. [See generally, Testimony of Michael E. Levine, before the Subcommittee on Aviation of the Committee on Public Works & Transportation in the House of Representatives, October 4, 1989.] These are not insubstantial national concerns. Indeed, many other countries have

similar, and some even stricter, laws and practices with respect to foreign investment.

### FOREIGN INVESTMENT PRACTICES OF OTHER COUNTRIES

At the request of the Committee, the Assistant Secretary of Transportation for Policy and International Affairs at the Department of Transportation prepared a report on the practices of other countries with respect to foreign investment in their airlines. The findings contained in the report are instructive. In a survey of about 32 countries, including the major U.S.-foreign air transportation markets, the report notes that five countries do not permit any foreign investment whatsoever in their airlines. Seventeen countries allow ownership or investment of 25 percent (the U.S. limit) or greater, but none over 49 percent foreign ownership. By law or practice, fully 31 of the countries surveyed have some kind of a domestic control requirement for their airlines.

None of this information should be surprising, however. An airline is a national resource of the first order, and sovereign nations have historically acted to protect that resource from inappropriate foreign influence. Consequently, if laws exist in the United States which effectively limit the amount of foreign ownership and control of a domestic carrier, we do not stand alone. As one noted authority in aviation stated: "If international aviation was a free market in which all airlines were legally permitted to enter all markets, there would be no reason to be concerned about foreign ownership. . . . But we don't have a world-wide open market in air transport." [See, Levine testimony.]

Accordingly, that restrictive foreign ownership rules around the globe may offend some is not a persuasive argument for the United States to unilaterally abandon its laws. We may well reach the point when there will be a fully integrated aviation market with cross border competition between differing flag carriers. At that time, a law limiting foreign ownership in a country's airlines may indeed be an anachronism; clearly, however, that day has not yet arrived and we have a distance yet to travel before getting there. Still, there are other reasons why consideration of foreign ownership issues are of significance in fashioning a national aviation policy.

### OTHER IMPORTANT CONCERNS ARE RAISED BY LEVERAGED BUYOUTS IN THE AIRLINE INDUSTRY

*1. Vulnerability of airlines*

Other considerations also raise doubts about the use of leveraged buyouts in the aviation industry. Airlines, unlike certain other business organizations, are particularly susceptible to economic downturns. They are heavily capitalized firms, and the cost of their equipment is substantial. Estimates are that the cost of aircraft now on order is about $100 billion. Airlines are also labor intensive, and many of their employees are highly skilled, well paid workers. Airlines compete through price and service offerings, and often the competition is cutthroat. In a recession economy, heavily leveraged firms are among the primary candidates for bankruptcy

because of the difficulty they have in meeting payments on the acquired debt.

*2. Risks to airlines, consumers, and the industry: Inadequate maintenance, lower bond ratings, bankruptcies, further consolidation, and a lack of competition*

Several consequences may flow from the difficulty of meeting debt obligations. The one that concerns me most and that S. 1277 is designed to prevent is a deterioration in safety. The primary area of an airline's service obligations is in the safety area. The temptation to trim the budget in safety areas that are not perceived to be first priority or easily noticeable is always a possibility. Employee reductions are often among the first responses to over-leveraged firms. A major reduction in maintenance and crew members involved in aircraft servicing might well contribute to an increase in the safety risk. The lag time between aircraft service visits could also increase.

Still related are other severe consequences that ultimately impact on safety. An airline's bond rating could be lowered, thus making it more difficult and more expensive to borrow money to meet existing obligations or to maintain a high quality of service on a competitive level. The impact, of course, is not limited to a company receiving a lower bond rating or being a greater credit risk. Bankruptcies and liquidations, touched off by the inability to service debt, are not uncommon in the airline industry. The bankruptcy potential of inordinately leveraged airlines is serious, and it is this potential that creates numerous other risks for consumers and industry as a whole.

The domestic aviation industry has been consolidated with a resulting loss in the benefits of competition to consumers. New entrants to the airline industry appear to be a thing of the past. We now have nine major airlines: American, Continental, Delta, Eastern, Northwest, Pan American, Trans World Airlines, United, and U.S. Air. Of these, one is in bankruptcy, another is teetering perilously close, one is recovering from a major recapitalization, three have been involved in recent takeover attempts, and two others are often mentioned as potential takeover targets. According to Standard & Poor's, "over half the industry's capacity would be provided by company's with speculative grade credit risk" if both the United and Northwest takeovers were accomplished. [Testimony of Phillip Baggaley before the Subcommittee on Aviation of the Committee on Public Works of the House of Representatives, October 4, 1989.]

CONCLUSION

Considerations such as these are entirely appropriate in evaluating a leveraged buyout in the industry. Airlines are expected to meet consumer demands; they are required to maintain exacting safety and quality standards; they must have the ability to modernize their fleets and replace aging aircraft; they have an obligation to support the infrastructure needs of the aviation industry; they must maintain a well trained work force to help meet safety requirements and service needs; and antitrust requirements mandate that they compete vigorously with one another.

The ability to fulfill these demands depend, in part, on financial health. Other factors are important as well, including good management, a favorable route system, productive employees, the goodwill of the travelling public, and a quality product. But safety is the linchpin of this industry, and it may well be compromised when an airline has lost its economic stability and the prospect of continued financial health due to a leveraged buyout.

Some who oppose this legislation have suggested that airlines are mature companies, and those who run them shrewd business generals. Thus, the government should limit its role in reviewing transactions. I quite agree that business is ordinarily a better judge of what is good for business than government. Of course, more than business dealings are at stake in an airline LBO, and Congress cannot abandon its policy role to the brinkmanship of investment bankers, lawyers, market investors, shareholders, or anybody else. What may be simply a paper transaction to capital providers is a livelihood to baggage handlers, pilots, flight attendants, and others connected to the airline industry. The public expects airlines to ensure their safety to the maximum extent possible. S. 1277 strikes a delicate balance between dealmakers and policymakers, and I believe that, with time, it will prove to be a modest, but powerful tool in our effort to maintain the most competitive and safest airline industry in the world.

## CHANGES IN EXISTING LAW

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new material is printed in italic, existing law in which no change is proposed is shown in roman):

## FEDERAL AVIATION ACT OF 1958

### Section 401 of that Act

**CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY CERTIFICATE REQUIRED**

SEC. 401. (a) * * *
(b) through (r) * * *

*ACQUISITION OF CONTROL*

*(s)(1) It shall be unlawful for any person to acquire, directly or indirectly, a controlling interest in an air carrier, unless the Secretary of Transportation has made a prior determination, after notice and hearing, that the acquisition of such controlling interest will not adversely and materially affect such air carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety.*

*(2) Application for a determination by the Secretary under this subsection shall be made in writing to the Secretary, and shall be in such form and contain such information as the Secretary shall by regulation require. The Secretary shall issue a final order or decision with respect to a determination under this subsection not later than 90 days after the date of submission of such application.*

*(3) Prior to making a determination under this subsection with respect to an air carrier, the Secretary shall consider the likely effects of the proposed acquisition upon—*

*(A) the ability of the carrier to avoid any deterioration in established safety procedures;*

*(B) the existing commitments and future ability of the carrier to replace aircraft in its fleet with new aircraft;*

*(C) the existing commitments and future ability of the carrier to expand its aircraft fleet through the purchase or lease of new aircraft;*

*(D) the ability of the carrier to continue to meet its commitments to maintain and improve airport and related ground facilities;*

*(E) the ability of citizens of the United States to control the carrier, in light of aspects of the proposed acquisition that may affect such control, including any equity proposed to be contributed by a foreign air carrier; and*

*(F) competition in foreign air transportation.*

*(4) The proponent or proponents of the acquisition of a controlling interest shall bear the burden of proving that the proposed acquisition will not adversely and materially affect the air carrier's fitness and ability to conduct air transportation in a manner consistent with the highest degree of safety. If the Secretary determines that the proposed acquisition would adversely and materially affect the carrier with respect to one or more of the factors set forth in paragraph (3), the Secretary shall issue a determination disapproving the acquisition.*

*(5) As used in this section, "controlling interest" means, with respect to an air carrier, direct or indirect ownership of 25 percent or more of the voting stock of such air carrier.*

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